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DE RUEHAN #0265/01 1000826
ZNR UUUUU ZZH
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FM AMEMBASSY ANTANANARIVO
TO RUEHC/SECSTATE WASHDC 2317
RUCPDOG/DEPT OF COMMERCE WASHDC
RUEATRS/DEPT OF TREASURY WASHDC

UNCLAS ANTANANARIVO 000265

SENSITIVE
SIPDIS

DEPARTMENT FOR AF/EPS AND AF/E - MBEYZEROV
DOC FOR DESK OFFICER - BECKY ERKUL
TREASURY FOR FRANCOIS BOYE

E.O. 12958: N/A
TAGS: [ETRD](#) [EINV](#) [ECON](#) [MA](#)
SUBJECT: MADAGASCAR: ECONOMY SUFFERS AS CRISIS CONTINUES

REF: A) Antananarivo 144 B) Antananarivo 252

11. (SBU) Summary: The political crisis in Madagascar has already negatively impacted unemployment, tourism, inflation, and exports. The economic downturn, increased inflation, and depreciation of the currency are likely to continue during 2009, with analysts predicting annual GDP growth of only 3 percent, compared to over 7 percent in 2008, assuming the political situation stabilizes by May - and lower if it does not. Although the economic downturn has mainly affected city-dwellers, the livelihoods of the three-quarters of the population who live in rural areas are also threatened by a proposed transition government plan to sell subsidized rice - a plan that could diminish incentives for producing rice and threaten the island's already precarious food security. End summary.
Impact of the Crisis: Unemployment Spikes

12. (U) In late January, following looting in cities throughout the country, hundreds of shops closed their doors. According to the business chamber GEM (Groupement des Entreprises de Madagascar), 10,000 workers lost their jobs during the two main days of looting (January 26 and 27) alone (ref A). The slowdown of economic activity during February and March due to political demonstrations and strikes then led many enterprises to lay-off additional workers. Since the beginning of March, up to 10 companies per day have declared plans to lay-off workers at the Ministry of Labor. Aid agencies estimate that as many as 50,000 workers had lost their jobs by late March.

Impact of the Crisis: Tourism Falls

13. (U) The tourism sector has been hard hit by the crisis, with foreign tourists cancelling their visits due to security concerns (ref A). According to the National Tourism Office, the cancellation rate was more than 80 percent for the first quarter. The hotel occupancy rate was estimated at less than 10 percent during this period (compared to 40% last year over the same period). Tourism operators were obliged to lay-off 60 percent of their employees. Total employment in this sector is estimated at 30,000, not including indirect employment in the transportation and handicraft sectors. Last year, 378,000 tourists visited Madagascar, and the sector yielded USD 393 million in revenue. Tourism was Madagascar's second most important source of foreign currency after the mining sector.

Impact of the Crisis: Inflation Increases

14. (U) Nationwide, monthly inflation for February reached 1.83 percent compared to 0.99 percent for January. Food, beverage, and tobacco prices increased by 2.8 percent between January and February, compared to 1.4 percent between December 2008 and January 12009. Price increases disproportionately impacted the capital, where looting was the most widespread. During the week following the looting in late January, the prices of rice, sugar and floor increased by more than 10 percent in Antananarivo whereas the price

of cooking oil increased by 70 percent. By the end of February, prices had stabilized, except for that of cooking oil which remained high.

Impact of the Crisis: Exchange Rate Depreciates

15. (U) In 2008 and the first two months of 2009, the Ariary appreciated against the Euro. However, the Ariary began to depreciate in the beginning of March. On March 1, one Euro was worth 2440 Ariary, but by March 31, one Euro was worth 2611 Ariary, representing a 7 percent depreciation of the Ariary in one month. Transactions on the foreign exchange market declined to EUR 69.7 million in March 2009, compared to EUR 84.7 million in February 2009, a 17.7 percent decrease. The Ariary also began to depreciate more rapidly against the U.S. Dollar in late March, and transactions on the foreign exchange market declined from USD 165.6 million in February 2009 to USD 110.13 million in March 2009. The depreciation stems from the decrease in tourism activities and exports which are the main sources of foreign currency for the economy. Depreciation will be compounded by the reduction in foreign investment flows to Madagascar, as well as by the cuts in foreign aid by donors in response to the illegal coup d'etat in March.

Impact of the Crisis: AGOA Exports Decline

16. (U) Compared to last year, exports under the African Growth and Opportunity Act (AGOA) have decreased this year. Exports under AGOA amounted respectively to USD 15.7 million and 15.5 million in January and February 2009 (compared to USD 17.8 million and 16.6 million in 2008). This decline resulted partly from the global financial crisis, which has led to declining demand for garment exports in the West, and partly from buyers' reluctance to place orders from Madagascar given the political uncertainty.

Predicted Impact: Exchange Rate Depreciation

17. (SBU) The depreciation observed since March will continue. Madagascar's main sources of foreign currency are exports, tourism, foreign investment, and foreign aid. Tourism was harmed by the political crisis. Exports are declining due to decreasing global demand and the political crisis. Foreign aid will be reduced following the decision of some donors to cut aid programs in Madagascar. FDI, which was driven by the construction of two large mining projects in 2007, began to fall in 2008 as construction neared a close in one project and slowed down in the other. In early 2009, QMM, a large Rio Tinto investment in the South, entered into operation, while the Ambatovy project in the East slowed construction due to a credit crunch. Because of all these factors, the supply of foreign currency cannot keep pace with demand, and further depreciation of the Ariary is likely.

Predicted Impact: Increased Inflation

18. (U) Although depreciation may give a needed boost to exporters by making their products cheaper for foreign buyers, depreciation has generally been associated with high inflation in Madagascar. The country imports most of its consumer goods and all investment goods, including fuel. As the value of the Ariary falls, the local currency price of imported goods will increase, leading to an increase in overall prices.

Predicted Impact: Declining Fiscal Revenue

19. (U) Two months of strikes and demonstrations and a lower than normal level of economic activity will result in lower tax revenue. The government will have difficulty financing its current expenditure due to this declining revenue and donors' suspension of aid, which accounts for around one-quarter of the government budget (ref B). Although the government's consumption represents only 4 percent of GDP, a decrease in this expenditure will affect the government's suppliers and contractors, which will face lower demand for their products.

Predicted Impact: Lower Economic Growth

110. (U) The increase in unemployment will result in the reduction of private consumption by households, and thus a reduction in total demand for consumer goods such as food, textiles, and services. The

decline of the tourism sector will spill over into other sectors, including transportation, agriculture and other services. A decline in exports will affect not only producers and exporters, but also companies providing export services, including transportation. Given that the services sector accounts for more than half of GDP, a decline in commercial and service activities will strongly impact the whole economy. The vicious cycle of reduced economic activity-unemployment-low income-low demand will result in lower economic growth compared to 2008. Economic analysts project a growth rate of 3 percent for 2009, assuming that the crisis ends in May and that the tourism sector resumes its activities during the high season beginning in June. If the crisis continues, growth projections will be lower.

Subsidized Rice

¶11. (SBU) The Ravalomanana administration had launched a "green revolution" in 2008 to boost Madagascar's rice yields by adding a second harvest and providing farmers with improved seeds and fertilizer. The progress made over the last year has been threatened by the transition government's announced plan to sell subsidized rice at half the market price. Roughly three-fourths of the island's population live in rural areas and rely on rice farming and raising cattle to survive. Dumping below-cost rice on the market could cause the market price to fall, resulting in lower returns for farmers. The scale and duration of the program are not yet known, but it has the potential to disrupt the rice market, provide disincentives for production, and eventually threaten the island's precarious food security.

Comment

¶12. (SBU) The rice subsidy program, which favors the small, politically active urban population to the detriment of the large, apolitical rural one, is no doubt politically motivated. The transition regime has also pledged cheap oil, bread, and transportation in populist attempts to court supporters in cities throughout the island. End comment.

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